

The U.S. Treasury Department

Summary Response to Recommendations in the December 2008 GAO Report

January 16, 2008

Introduction: The Treasury Department (Treasury) welcomes the 9 recommendations on the TARP made by the GAO in its December 2008 report. Treasury has attempted to keep the GAO apprised of all of its progress on these recommendations. The goal of this report is to provide a written, high level summary of Treasury's progress on the GAO recommendations and to identify the next steps that Treasury is taking in these areas.

The report is structured as follows:

- Identification of the GAO recommendation
- Summary of Treasury's status on that issue at the time of the report's issuance
- High level illustration of Treasury's progress on the issue
- Identification of next steps Treasury will take.

GAO Recommendation 1: Work with bank regulators to establish a systematic means of monitoring and reporting on whether financial institutions' activities are consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency.

Status at first GAO report:

- No regular processes were in place to capture and analyze data from financial institutions participating in the CPP.

High Level Summary of Progress since First GAO Report:

- Treasury has been working constructively with the banking regulators to design a program to monitor the activities of banks that have received TARP capital. Treasury plans to use quarterly call report data to analyze changes in the balance sheets, loan provisioning, and intermediation activities of institutions we have invested in, and compare their activities to a comparable set of institutions that have not received TARP capital investments. Because call report data is infrequent, Treasury will augment that analysis with a monthly survey of the 20 largest recipients of Capital Purchase Program (CCP) capital. This monthly survey, which Treasury sent on January 16, 2009, focused on lending and intermediation activities and included both financial data and commentary from the banks.
- Treasury has received clearance from OMB on its survey for the 20 largest investments and distributed the survey to those institutions on January 16, 2009. Treasury will collect data through December 31, 2008. The initial responses are due January 31, 2009. Going forward, each survey will be due to Treasury within 30 days of the end of each reporting period.
- Depending on the results of the monthly survey and call report analysis, Treasury may also ask the four bank regulators to gather information directly from CPP-recipient banks during their periodic on-site examinations. The FDIC has recently initiated its own monitoring program covering state non-member banks use of TARP capital injections, Fed liquidity

support and FDIC financing guarantees. It may make sense for the four banking agencies to collaborate with Treasury on a developing a common approach.

- Treasury has explored commissioning research from the banking agencies on bank lending patterns during previous recessions. This analysis might provide an historical perspective and would help provide a context for the lending results coming out of the surveys described above.
- The Office of Financial Stability (OFS) has continued to fill key positions related to monitoring and reporting. A financial analyst has been hired to analyze call report data on a quarterly basis as well as analyze the monthly survey of the 20 largest CPP participants. In addition, the OFS has created a position for a Director of Analytics and Mission Metrics and is currently interviewing candidates.

Next steps:

- Treasury is continuing to design appropriate metrics to measure the effectiveness of the various programs under TARP. This includes coordinating with the banking regulatory agencies to determine how Treasury can leverage information that is already collected as well as designing new data and tracking mechanisms.
- The OFS is building its capacity to design and track performance measures.

Recommendation 2: Develop a means to ensure that institutions participating in CPP comply with key requirements of program agreements, including those covering limitations on executive compensation, dividend payments, and the repurchase of stock.

Status at first GAO report:

- At the time GAO issued its first report under section 116(a) of EESA, Treasury had put in place an Interim Chief Compliance Officer (CCO) to lead the compliance function within the OFS and had started recruiting individuals to support the Office of the CCO. Additionally, Treasury had issued an interim final rule in Part 31 CFR 30, providing guidance on the executive compensation limitations applicable to participants in the CPP. Treasury had also issued guidance on the executive compensation restrictions applicable to institutions participating in the program for Systemically Significant Failing Institutions (Notice 2008-PSSFI) and to institutions whose troubled assets might be purchased by Treasury through an auction purchase (Notice 2008-TAAP).

High Level Summary of Progress since First GAO Report:

- Since the first GAO report, the Office of the CCO has hired a Director of Compliance and two Compliance Analysts. Treasury reviewed public comments on its interim final rule for executive compensation and prepared a second interim rule that was published on Treasury's web site on January 16, 2009. This interim final rule provides further guidance on the executive compensation limitations applicable to CPP participants and includes reporting and recordkeeping requirements for participating institutions, requiring an institution's primary executive officer to certify annually to Treasury regarding compliance with compensation

restrictions. The Office of the CCO is in the early stages of developing a program to oversee and enforce compliance with the executive compensation restrictions set forth in EESA, Treasury guidance, and contracts. The first certifications pertaining to executive compensation for CPP participants are due in mid-February.

Next steps:

- The Office of the CCO will continue to develop and will implement a rigorous compliance program for the TARP. With regard to executive compensation by CPP participants, the program will include receipt, review, and necessary follow-up of executive compensation certifications, including those certifications required by the interim final rule for the CPP, which was released on January 16, 2009. In appropriate cases, Treasury will also consider the use of other mechanisms to oversee and enforce compliance with the executive compensation requirements, including in depth reviews of compensation practices by individual institutions receiving CPP funds, litigation to enforce the securities purchase agreements and the regulations, referrals to the Special Inspector General, and publicizing the identity of institutions who violate executive compensation restrictions. In addition, the Office of the CCO is continuing to focus on recruiting and interviewing highly qualified candidates to fill positions within the compliance program.

Recommendation 3: Formalize the existing communication strategy to ensure that external stakeholders, including Congress and the public, are informed about the program's current strategy and activities as well as the rationale for changes in this strategy to avoid information gaps and shocks.

Status at first GAO report:

- Treasury had used reports to Congress, Congressional testimony, and speeches and interviews by senior Treasury officials as a means to keep all stakeholders informed of the program's status and strategy.

High Level Summary of Progress since First GAO Report:

- Treasury has continued to meet all of its reporting requirements on time, and has posted all reports, speeches and testimony on the EESA website: <http://www.treas.gov/initiatives/eesa/>. Treasury has increased its outreach to ensure that all stakeholders are informed of TARP program developments as they occur.
- Since the December 2008 GAO report, Treasury has issued the following reports:
 - 8 transaction reports: <http://www.treas.gov/initiatives/eesa/transactions.shtml>
 - 2 tranche reports: <http://www.treas.gov/initiatives/eesa/tranche-reports.shtml>
 - 2 section 105 reports: <http://www.treas.gov/initiatives/eesa/congressionalreports.shtml>
 - 1 section 102 report: <http://www.treas.gov/initiatives/eesa/congressionalreports102.shtml>

- 1 response to questions from the Congressional Oversight Panel:
<http://www.treas.gov/press/releases/hp1336.htm>
- Treasury officials also participated in Congressional hearings regarding the TARP on December 4 and December 10:
 - <http://www.treas.gov/press/releases/hp1312.htm>
 - <http://www.treas.gov/press/releases/hp1322.htm>
- Treasury officials also made public remarks on the program's status on 6 occasions:
 - <http://www.treas.gov/press/releases/hp1301.htm>
 - <http://www.treas.gov/press/releases/hp1314.htm>
 - <http://www.treas.gov/press/releases/hp1321.htm>
 - <http://www.treas.gov/press/releases/hp1332.htm>
 - <http://www.treas.gov/press/releases/hp1347.htm>
 - <http://www.treas.gov/press/releases/hp1349.htm>

Next steps:

- OFS leadership will work closely with the new Administration to develop a coordinated and effective communications strategy for the program to ensure all stakeholders are informed of program developments.

Recommendation 4: Develop a definitive transition plan by building on and formalizing ongoing activities to facilitate a smooth transition to the new administration, including ensuring that key OFS leadership positions are filled during and after the transition to the new administration.

Status at first GAO report:

- Immediately after the election, Treasury began updating and consulting with the Transition team to keep them informed of our actions and progress. The Transition team responded by encouraging Treasury to continue executing our programs and building our operations, while keeping them informed.

High level summary of progress since first GAO report:

- Since the GAO report, Treasury has continued to post the Transition team on TARP developments, including new programs and operational progress. The Transition team has met with TARP leadership, including each of the Chiefs.
- TARP leadership has been very focused on making sure the transition to the next Administration is seamless, especially due to the on-going program execution requirements, such as weekly CPP investments. The most effective way to ensure a seamless transition is to ensure that the staff running the program is in place throughout the Transition.

- TARP leadership worked hard to find long-term leaders to run the program throughout the Transition and beyond. For example, TARP's interim Chief Financial Officer (CFO) was scheduled to return to his agency in early January. Treasury believed it was a high priority to identify a permanent CFO and provide time for the two to overlap to ensure continuity of operations and a seamless transition. Treasury hired a new, permanent CFO who overlapped with the interim CFO and has now successfully transitioned into the new position.
- Similarly, our interim CPP program manager was due to return to Chicago in early January. We identified a permanent CPP program manager who joined in early January, providing an opportunity for overlap with the interim manager and a smooth hand-off of a critical and complex operation.
- The Assistant Secretary role and possibly the role of CIO are political positions. As such, it was difficult for the current Treasury leadership to identify long-term leaders for those positions. Recognizing the importance of continuity, the Transition team asked the current Interim Assistant Secretary and Interim CIO to remain in their posts for some time after inauguration. Both have agreed, providing strong continuity in these roles to ensure a smooth transition.
- The only leadership posts that are not currently occupied by people who plan to remain after inauguration are the Chief Risk Officer (CRO) and Chief of Homeownership Preservation. In both cases, very strong teams have been assembled in those offices. The Homeownership Preservation role may end-up being a political position given the likely foreclosure mitigation policies that will be developed. In addition, the CRO role is an important role, but the Transition team has encouraged us to take our time to find the right candidate, ideally with a mix of public and private sector expertise. Given the strong team in the Risk Office, and the strong leadership of the other Chiefs, the current Treasury and the Transition team agreed that a brief period potentially between CROs would be manageable.

High Level Summary of Progress since First GAO Report:

- We are aggressively continuing our search for a permanent CRO. In addition, we continue to post the Transition team on program developments. Given that virtually the entire TARP team will now remain in place for some time beyond inauguration, we are confident the Transition will be seamless.

Recommendation 5: Continue OFS hiring efforts in an expeditious manner to ensure that Treasury has the personnel needed to carry out and oversee TARP.

Status at first GAO report:

- Treasury was in the process of recruiting and hiring well-qualified career staff that will be able to stay on in their positions on a long-term basis. The OFS had about 48 employees, including 5 permanent employees, assigned to TARP as of November 21, 2008. Treasury was prioritizing its hiring process by filling senior career positions first.

High Level Summary of Progress since First GAO Report:

- The OFS has filled or selected candidates for key leadership positions, including Chief Operating Officer, Chief Financial Officer, Director of Compliance Program, Equity Program Director, Deputy Chief Risk Officer, Director of Financial Agents, and Contracts Administration Manager. Other senior appointments have included the Executive Secretariat, the Internal Controls Program Leader, and Deputy Director for the Equity Program. Appointments are pending for the Middle Office Manager and a senior position in the Risk Office.
- Treasury has been operating TARP with a staff of approximately 140 people, including long-term TARP employees, detailees, and other Treasury employees. Over time, TARP is shifting from reliance on Treasury staff to long term OFS staff, and we have a robust pipeline of outstanding new people joining OFS each week. As of January 15, the OFS had a staff of 88 employees, including 28 long-term staff. By the end of January, the OFS will have a staff of approximately 100 employees, including 40 long-term staff. In addition, the OFS continues to benefit from broad support across the Department of the Treasury. Finally, a number of individuals detailed to the OFS from within Treasury or other federal organizations have expressed interest in staying with the program. These detailees are expected to remain with the program until they transition into OFS positions or until permanent staff is identified.
- While the OFS has moved quickly to add staff, Treasury has exercised appropriate caution to ensure a thorough and rigorous ethics vetting process. This has marginally increased the time it takes to on-board employees after selection.

Next steps:

- The OFS continues to attract interest from excellent private and public sector candidates. The OFS has established effective processes for reviewing applications and there is broad involvement of the OFS staff in the recruitment and interviewing process. The OFS is continuing to interview candidates for leadership and staff positions and expects to increase the hiring rate, while remaining mindful that TARP is a program created to fill a temporary need.

Recommendation 6: Ensure that sufficient personnel are assigned and appropriately trained to oversee the performance of all contractors, especially those performing under contracts priced on a time and materials basis, and move toward greater reliance on fixed-price arrangements, whenever possible, as program requirements are better defined over time.

Status at first GAO report:

- Treasury had exercised its authority under the act to retain financial agents to provide services on its behalf, as well as entering into a variety of contracts and blanket purchase agreements under the Federal Acquisition Regulation for legal, investment consulting, accounting, and other services that are generally available in the commercial sector.

High Level Summary of Progress since First GAO Report:

- The OFS has been adding additional procurement management, procurement services, and financial agent management personnel to effectively manage TARP contracts and financial agents.
- The OFS has created a new SES Contracts Administration Manager position, which the department expects to fill by the end of January. The contract administration manager will report to the TARP Chief Operating Officer and will oversee TARP's long range requirements planning, apply contract management best practices to TARP's contracts and financial agent agreement, and provide contract management leadership and guidance to TARP's Contracting Officer Technical Representatives (COTRs) and financial agent management personnel.
- The OFS also has created an SES Director for Financial Agents to help oversee a Manager of the Custodian/Infrastructure Provider and a Manager of the Asset Managers, both of whom will in turn supervise a team of staff-level vendor managers. Two of these three management positions should be filled in January, and an experienced vendor manager will start on January 31. In addition, after the asset managers are selected, Treasury's investment consultant, Ennis Knupp, will have an ongoing responsibility to provide advice and assistance in ensuring proper performance by the asset managers.
- Treasury's Procurement Services Division is currently reviewing over 40 applicants for two high level Supervisory Contract Specialists positions that will form the leadership core of the procurement team to support OFS full time.
- The TARP has continued to recruit a number of experienced COTRs into the OFS to ensure effective contract management at the staff level. In the meantime, executives in the OFS and the Office of the General Counsel continue to carefully manage our contracts.
- In addition, contracting staff continues to work closely with requirements owners to identify opportunities for greater use of firm fixed price contracts, where such contracts will maximize value for the taxpayer, as well as minority- and women-owned small business participation.
- Finally, while the transition to permanent and more experienced COTRs has been underway, the Procurement Services Division (PSD) has instituted a twice per month contract

performance report requirement for each OFS procurement. These reports facilitate contract cost and quality control. PSD analyzes these reports and prepares a COTR Reports Analysis for OFS, which is discussed in a bi-weekly meeting with the Chief Operating Officer. The COTR Reports Analysis report helps to identify and resolve contract performance and compliance issues at an early stage. The OFS also has carefully monitored its financial agent agreements, through monthly meetings with the financial agent's senior management and regular analysis of scope and performance.

- In addition, the OFS continues to host periodic "procurement summit" meetings that include broad representation from employees across the Treasury Department with a role in OFS procurement and financial agent agreements. The summits facilitate communication and coordination with respect to requirements planning and contract management. PSD also has provided interim training, support and recommendations to the OFS with respect to OFS contracts.

Next steps:

- The OFS will complete these planned hiring actions, and add to the staff of vendor managers as additional firms are selected as asset managers over time.

Recommendation 7: Continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that program's objectives and requirements are being met.

Status at first GAO report:

- When GAO completed its first report, the OFS had hired external support (PricewaterhouseCoopers) to support the development of internal controls. A number of key controls had been established for the program active at that time - the CPP.

High Level Summary of Progress since First GAO Report:

- The OFS has approached the development of internal controls with both a short term and long term vision. The short term vision is to have controls in place for the highest financial risk activities first. To this end, the OFS has developed core controls for the programs currently operating: CPP, SSFI, TIP and AIFP. The weekly CPP deal closings have been completely documented. The OFS is relying on existing Treasury operations and controls for many of the support functions (e.g. budget, human resources and procurement), but has also made progress developing controls for OFS specific functions. A document provided to GAO by OFS this past week- "OFS Internal Control Status as of 1/14/09"- provides a list of controls and control related activity to date.
- The OFS has also made progress on developing a long term vision for internal controls. An Internal Control Framework (previously provided by the OFS) has been created and the management team is using it to focus discussions on a range of organizational issues including internal controls. We anticipate the framework will continue to evolve as the organization continues to grow and mature.

Next Steps:

- The OFS will develop an implementation plan for the Internal Control Framework. An area of initial focus will be financial reporting as the OFS develops its financial statement processes and prepares for the financial statement audit GAO will be conducting this year

Recommendation 8: Issue final regulations on conflicts of interest involving Treasury's agents, contractors, and their employees and related entities as expeditiously as possible, and review and renegotiate mitigation plans, as necessary, to enhance specificity and compliance with the new regulations once they are issued.

Status at first GAO report:

- When GAO published its first report on the TARP, Treasury had in place several measures to address conflicts of interest. Treasury had published and was implementing interim guidelines for addressing conflicts of interest that may arise with vendors seeking work under the Troubled Asset Relief Program. These guidelines supplemented the conflicts provisions applicable through the Federal Acquisition Regulation. Treasury was also drafting interim final regulations on conflicts of interest

High Level Summary of Progress since First GAO Report:

- After an extensive review process within Treasury and interested agencies, Treasury has completed interim final conflicts regulations and sent them to the Federal Register on January 14 for publication. The regulations describe information that Treasury will require vendors to provide when bidding for contracts, the conflicts reviews they must undertake during the life of the contract, and the certifications they must provide to demonstrate compliance, among other measures. A copy has been sent to GAO under separate cover.
- While these regulations were being finalized, Treasury continued to apply the interim guidelines and to scrutinize its vendors for conflicts. As part of the process for hiring asset managers, for example, Treasury has obtained and is reviewing very detailed information about potential conflicts, mitigation strategies, codes of ethics, and other compliance policies and practices from each candidate. Treasury has also obtained guidance from its consultant, Ennis Knupp, on evaluating the potential for conflicts and possible mitigation measures in the asset manager program.

Next steps:

- Treasury has already begun a review of its contracts to determine whether changes or additional requirements are necessary in light of the new conflicts regulations, and this work will continue. Because Treasury has been implementing conflicts requirements under its interim guidelines and the Federal Acquisition Regulation, we do not anticipate that this review will reveal the need for fundamental changes in our contracts

Recommendation 9: Institute a system to effectively manage and monitor the mitigation of conflicts of interest going forward.

Status at first GAO report:

- When GAO issued its first report, Treasury was taking several measures to address conflicts of interest for TARP vendors. As mentioned above, Treasury routinely considered conflicts as part of its procurement process, based on requirements in Treasury's interim guidelines and the Federal Acquisition Regulation. Through these measures, Treasury was able to identify vendors who may have conflicts, obtain information about those conflicts, and impose contractual requirements relating to conflicts. Among these vendors are law firms whose lawyers are bound by professional codes of ethics, enforced by state bars, to identify, manage, and prevent conflicts of interest. These measures – regulatory, contractual, and professional codes – have been part of Treasury's system for managing potential conflicts among its vendors.
- Also at the time of GAO's first report, Treasury was implementing a system for managing potential conflicts with the law firms that handle CPP closings. Treasury regularly used two law firms to handle these closings. Before a firm was assigned to close a transaction, Treasury would send both firms a list of approved institutions as part of a conflicts review process. If a firm had a conflict, the pertinent transaction was assigned to the other law firm for closing. If both firms had a conflict, the work would be assigned to a third firm. This system prevented conflicts from arising, thereby avoiding the need for mitigation measures.

High Level Summary of Progress since First GAO Report:

- As discussed above, Treasury has sent interim final regulations on conflicts of interest to the Federal Register. These regulations describe more formal processes for identifying, monitoring, and mitigating conflicts of interest during procurement and the contract term. For law firms handling CPP closings, Treasury continues to implement its system for addressing potential conflicts at law firms handling CPP closings. Treasury evaluates potential conflicts at law firms handling other transactions before hiring, and imposes conflicts requirements in their contracts as well. In general, Treasury has avoided the need to design and monitor mitigation programs by hiring vendors who do not have conflicts.

Next steps:

- Treasury will implement the conflicts regulations for new vendors and review existing contracts to determine what changes are needed. Treasury is currently designing conflicts provisions for the asset manager agreements, and when these are finalized, will be designing and implementing systems to monitor conflicts in this important area. As new staff is hired for the Office of the CCO, Treasury will design and implement additional measures to monitor existing vendors for conflicts.